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Supreme Court of the United States

OCTOBER TERM, 1943.

No. 466 - 468

DANIEL S. GILLMOR, HENRY H. ABRAMS and PYRAMID COMMERCIAL CORPORATION, suing on its own behalf and on behalf of all other owners and holders of First Consolidated Mortgage 5% Gold Bonds, etc.,

Petitioners,

—against—

THE INDIANAPOLIS GAS COMPANY and CITY OF INDIANAPOLIS,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

FRANK E. KARELSEN, JR.,
DONALD L. SMITH,
WALTER MYERS, JR.,
PAUL E. KERN,
Counsel for Petitioners.

COURT PRESS, 130 Cedar Street, N. Y. C.

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THE INDIANAPOLIS GAS COMPANY and CITY OF INDIANAPOLIS.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The petitioners, Daniel S. Gillmor, Henry H. Abrams, and Pyramid Commercial Corporation, respectfully pray that a writ of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above entitled causes on the 10th day of June, 1943, affirming the judgments of the United States District Court for the Southern District of Indiana (R. 421). The actions were tried together in the District Court and the appeals were consolidated in the United States Circuit Court of Appeals (R. 408).

Statement of the Cases.

The petitioners are the holders of $12,000, $30,000 and $21,000, respectively, in principal amount of First Consolidated Mortgage 5% Gold Bonds issued by the Indianapolis Gas Company (hereinafter called the "Gas Company") (R. 87-89). They seek to recover from the Gas Company six years unpaid interest which accrued on their bonds at the rate of 5% per annum from April 1, 1936 to April 1, 1942, as evidenced by interest coupons attached to the bonds.

These bonds are part of an original issue of $6,881,000 issued by the Gas Company on and after October 1, 1902. Each of the bonds is in the principal sum of $1,000 and expressly provides for the payment to bearer of interest at the rate of 5% per annum in semi-annual installments until October 1, 1952, when the principal becomes due, without right of prepayment (R. 297-299). The bonds are secured by a mortgage dated October 1, 1902, conveying to trustees all of the then owned or after acquired property of the Gas Company (R. 295-313).

The Gas Company, admitting the validity of the bonds and that interest as provided therein, was not paid during the said six years, contends that the right of these petitioners to recover such accrued interest, or any interest in the future, has been destroyed by the consummation, on May 1, 1942, of an extra-judicial Plan. More than a majority of the Gas Company bondholders accepted this Plan and surrendered their bonds and coupons for cancellation pursuant to the Plan. It is contended that such action of the majority bondholders is binding upon all non-assenting bondholders under Article VII in the mortgage securing the bonds, and that the non-assenting bondholders are therefore relegated to the sole right to surrender their bonds for cancellation upon

payment of the sum of $1121.67 per bond, or approximately $240 less than was due thereon on April 1, 1942.

The action by petitioner, Pyramid Commercial Corporation, is brought on its own behalf and on behalf of all other bondholders similarly situated. The holders of more than $200,000 in face amount of said bonds have joined in this action. Before answering, the Gas Company impleaded the City of Indianapolis (hereinafter called the "City") as a third party defendant liable over to it.

Article VII of the mortgage, which the Gas Company contends authorizes the majority bondholders to cut off the minority's rights in their bonds against the obligor provides (R. 308):

> "VII. The action of the Trustees in regard to the enforcing to any extent or in any manner, the lien created by this mortgage, either by taking possession, sale at auction, or by resort to judicial proceedings, or by any means authorized and contemplated hereby, and any and every suit, bill or proceeding in equity, or other action which may in any manner be had or taken for enforcing the lien hereby created for the securing the payment of said bonds and coupons, or for enforcing any of the trusts of this instrument, shall be at all times subject to the control of the holders of a majority in amount of said bonds then outstanding, their wishes being expressed in writing.
>
> "And it is further agreed that in case of any proceeding as hereinbefore authorized by reason of any default that may have occurred and continued as aforesaid a majority in interest of the bondholders, for the time being, shall have the right to agree upon a plan or scheme for reorganization, which plan or scheme, when so agreed upon in writing and signed

by such majority in interest, shall be in all respects binding and obligatory upon all the holders of such bonds or coupons."

The Plan which, it is contended, was consummated pursuant to the authority in the above quoted provision of the mortgage, was framed and submitted by the Gas Company to its bondholders individually (R. 143-145). Neither the Trustee nor the bondholders collectively took any part in the preparation or submission of the Plan or in the consummation thereof. No proceeding had ever been undertaken by the Trustee to enforce the lien of the mortgage or to declare the principal due (R. 84).

The purpose of the Plan, as stated by the Gas Company to its bondholders, was to effect a settlement with the City with respect to certain controversies theretofore existing between them (litigation having been dismissed for lack of jurisdiction by this Court on November 10, 1941) *Chase National Bank* v. *Indianapolis Gas Co.*, (314 U. S. 63) (R. 143). The Plan was designated and referred to in all communications to the bondholders, and in all of the Gas Company records, as an "Offer and Plan of Settlement" (R. 241).

The Plan provided, in essence, for the following:

(1) The Gas Company and the City would exchange general releases.

(2) The Gas Company would sell to the City all of its properties, without warranty as to the mortgage, for the sum of $9,694,575.20.

(3) Each bondholder who accepted the Plan by surrendering his bonds and interest coupons for cancellation, would receive the principal of his bond plus 2% interest for the past six years. A similar amount would be deposited in escrow for all bondholders who did not accept the Plan.

(4) The Gas Company, after payment of certain expenses, would distribute to its stockholders the balance of the purchase price at the rate of $39 per share (amounting to approximately $1,500,000).

The Plan further provided that it would be consummated if accepted, not by a majority of the bondholders, but "by the holders of such portion of the outstanding bonds as may, in the judgment of the City, render the consummation of the Offer and Plan of Settlement practicable" (R. 243).

Neither the provisions of the Plan nor any communication by the Gas Company to its bondholders set forth that the non-assenting bondholders' rights against the obligor would be abridged or destroyed by the consummation of the Plan. The Gas Company refused to answer bondholders' specific inquiry on this point (R. 147-150). The bondholders were also refused a bondholder's list in order to communicate with each other with respect to the Offer and Plan of Settlement (R. 151). The first time the Gas Company asserted that the Offer and Plan of Settlement was intended as a plan or scheme of reorganization under the mortgage provision or that the rights of non-assenting bondholders against the obligor would be destroyed by the consummation of the Plan, was after these actions were instituted.

Upon consummation of the Plan, the Gas Company turned over to the City all of its properties. The mortgage, however, "still continues in full force as security for any and all rights which any holder of said bonds or coupons may have by virtue of his ownership thereof" (Gas Co. Answer R. 19). The Gas Company agreed with the City to effect its dissolution as soon as possible, and the distribution of its assets to its stockholders was designated as "liquidating dividends".

Rulings of the Courts Below.

The District Court directed judgment against the petitioners. It wrote no opinion and for its conclusions of law merely set forth that it found the law to be against the petitioners.

The Circuit Court of Appeals affirmed the judgment of the District Court. In its opinion, the Circuit Court set forth that Article VII of the mortgage provided that whatever action might be taken to secure payment of the bonds and coupons was subject to the control of the majority bondholders. The Court stated that the cases of *Sage* v. *Central Co.*, 99 U. S. 334, and *Elwell, Trustee* v. *Fosdick*, 134 U. S. 500, presented analogous situations and that in the light of those decisions the petitioners were bound by the action of the majority of the bondholders in accepting the Plan.

A petition for rehearing was denied by the Circuit Court of Appeals.

Questions Presented.

1. Whether the right conferred in a mortgage upon the majority bondholders to control the actions of the Trustee with respect to the enforcement of the lien of the security and in the event of such proceedings by the Trustee, to agree upon a plan of reorganization binding upon the minority bondholders, may be extended by implication to authorize the majority bondholders to abridge the rights of the minority on their bonds against the obligor by whatever action might be taken by the majority bondholders?

2. Where a mortgage does not, expressly or by necessary implication, authorize the majority bondholders to

abridge the rights of the minority bondholders against the obligor aside from the mortgage security, are the minority bondholders bound by the action of the majority in accepting an extra-judicial plan which involves neither the action of the Trustees nor the mortgage security?

3. Are non-assenting bondholders deprived of their property without due process of law when their rights against the obligor are held to be destroyed by an extra-judicial plan, which plan does not under any fair construction provide that non-assenting bondholders will be bound thereby, and where reasonable opportunity to protect their interests was denied to non-assenting bondholders through the concealment by the obligor of any purpose or effect of the Plan to bind non-assenters?

Reasons for Granting the Writ.

1. The decision of the Circuit Court of Appeals for the Seventh Circuit is in conflict with the applicable decision of the Circuit Court for the Eastern District of Virginia in *Manning* v. *Norfolk Southern R. R. Co.*, 29 Fed. 838, which held that the provisions of a mortgage authorizing majority bondholders to waive a default in interest could not be extended by implication to bar the non-assenting bondholder's right to recover such interest from the obligor.

2. The decision of the Circuit Court of Appeals in the instant case is in conflict with the weight of authority governing the construction of mortgage provisions authorizing control by majority bondholders over the minority. The decisions uniformly hold that such mortgage provisions are to be strictly construed in favor of the minority and that the rights of the minority bond-

holders against the obligor are not to be destroyed or abridged by action of the majority unless the mortgage contains explicit authorization therefor. (*Farmers Loan & Trust Co.* v. *Chicago & A. R. Co.*, Circuit Court, Seventh Circuit, 27 Fed. 167; *Mayo* v. *Fitchburg & L. St. R. Co.*, 269 Mass. 118, 168 N. E. 405; *Meissner* v. *Ogden L. & I. R. Co.*, 65 Utah 1, 233 P. 569; *McClelland* v. *Norfolk S. R. Co.*, 110 N. Y. 469, 18 N. E. 237.)

3. The question of construction of mortgage provisions authorizing the majority bondholders to control the minority is a matter of vital public interest. Numerous mortgages securing bonds sold to the general public contain provisions for majority control with respect to the actions of the trustee and the disposition of the mortgage security. If such limited provisions for majority control are to be extended by broad implication to include the right of the majority to control the minority in whatever actions might be taken to secure payment of the bonds and coupons, the rights of bondholders would be substantially diminished. The obligation contained in their bonds would become uncertain and conditional, and the bonds would be rendered non-negotiable. The bondholders would also lose their right to judicial supervision of any plans affecting their interests, since apparently the standards of fairness required under judicial reorganizations do not apply to voluntary reorganizations. An obligor could, as was done in the instant case, provide for substantial payments to its stockholders at the same time that it refused to pay its bondholders the moneys due on their bonds and interest coupons.

4. The non-assenting bondholders herein have been deprived of their property without due process of law by the decision of the Circuit Court, holding that they are

bound by the extra-judicial plan, regardless of the fact that the plan does not expressly or by reasonable implication provide that it shall bind non-assenting bondholders, and regardless of the fact that the non-assenting bondholders were deprived through concealment by the obligor of the purpose and purported effect of the plan, of any reasonable opportunity to protect their rights.

Despite the earnest contentions of the petitioners in the Court below, that the plan by its terms constituted an offer binding only upon those who accepted the plan, the Circuit Court concerned itself only with the question of the authority of the majority bondholders to bind the minority. The Court stated in its opinion:

> "In the view we take of the instant case, the question for decision is whether the plan was authorized by the terms of the mortgage deed of trust. If it was, and if there was sufficient notice in the bonds to make them subject to the conditions in the deed of trust, the judgment of the District Court must be affirmed" (R. 482).

The Circuit Court also failed to pass directly upon the point presented by the petitioners that by reason of the concealment by the Gas Company of any purpose or effect of the plan to bind non-assenting bondholders, they were deprived of any reasonable opportunity to protect their rights by preventing the consummation of the plan. The Court in its opinion stated on this question:

> "Plaintiffs have also stressed the point that Article VII is inapplicable for the reason that the conditions precedent required by that Article did not exist at the time of the offer and plan of settlement, and that the plan was neither framed nor submitted

as a plan or scheme of reorganization. These we have considered, but they do not change the conclusions we have reached and because of the views we have already expressed, they need not be discussed" (R. 485).

It is apparent that the Circuit Court deemed the provisions of the plan and the method of its presentation to bondholders, legally immaterial in view of its finding that the mortgage contained authority for the majority bondholders to bind the minority to whatever action might be taken. But the undeniable fact is that the authority *per se* could not destroy the rights of the minority. Only a plan which expressly or by reasonable implication provided for such destruction of the minority's rights could do so. And this question the Court did not pass upon.

Petitioners submit that these cases show a flagrant violation of the fundamental rights of bondholders. The Court has held that the petitioners' rights against their obligor have been cut off despite the clear showing that the plan by its terms does not so provide and despite the deprivation of any reasonable opportunity to bondholders to protect their interests.

The decisions herein vitally affect the public interest. The approval by the Circuit Court of the method adopted by the Gas Co. will undoubtedly constitute an encouraging precedent for numerous other obligors to whose advantage it will be to destroy their obligations without judicial supervision and without effective opposition by the individual bondholders.

Conclusion.

For the reasons hereinabove set forth, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

Daniel S. Gillmor, Henry H. Abrams and Pyramid Commercial Corporation,

By: Frank E. Karelsen, Jr.,
Donald L. Smith,
Walter Myers, Jr.,
Paul E. Kern,

Counsel for Petitioners.